

The Mortgage Business: Returning to Profitability

Six ways to help shape the mortgage business of the future

“I wonder if the mortgage business can ever be profit-making like it used to be ...” lamented a bank executive. Time and again, we have heard this sentiment expressed in recent conversations with bankers. And, while there is some truth to margin compression from regulatory scrutiny and volatility in volumes, there is indeed a “secret sauce” to returning the mortgage business to profitability. The answer lies in the sum of the parts—ideas that require thorough attention to the profitability factors of the mortgage lending business, extending from sales and fulfillment to service and collections.



As economic news and indicators begin to look better—with banks’ financial results improving on both sides of the Atlantic—there is growing optimism that the worst is behind us. The crisis may have been caused by financial instruments and the inability of participants to fully understand the inherent risk of structured products, but in a clear case of “biting the hand that feeds it,” the mortgage-based securitization market has had a pronounced negative impact on the origination, servicing and collections activities that comprise the core of the mortgage business.

The low interest rate environment has clearly fueled a rise in refinancings in the near term, putting pressure on the acquisition machinery and, coupled with other factors such as regulatory changes, having a negative impact on cycle time. Servicing operations are still reeling under the pressure of increased audits, investors’ requirements, and regulatory scrutiny.

Collections and default management operations have been the hardest hit as more distressed borrowers forced lenders to significantly expand the size of their operations. This is further compounded by the need to expand skills and capabilities in order to offer appropriate workout solutions to borrowers while mitigating losses for the lender. Foreclosure and REO management are also playing a more central role.

Over the next few years as many of these trends work themselves out of the system, there remains a dire need for mortgage players at each step in the value chain to take actions to manage the near-term impact—both in cost and performance.

Six Ways to Bring Order

What should mortgage companies do to address today’s challenges? There are numerous possibilities, but our focus in this paper is on six approaches to improve productivity and reduce costs.

Reorganization, process redesign, IT enablement, sourcing, outsourcing and demand management are the “secret sauce” for returning the mortgage business to profitability.

Let's start by establishing what an approximate expense profile might look like for a typical full-service operator (see figure 1).

Six primary levers are available to manage and optimize costs and operations: process redesign, reorganization, IT enablement, outsourcing and offshoring, sourcing and demand management. By applying these in a rigorous, thoughtful manner, our clients have achieved cost reduction objectives of 10 to 20 percent.

Let's look at each more closely. **Process redesign** seeks to change how work is performed by standardizing and streamlining core operations, instituting process metrics and measurement, and continually seeking ways to improve performance. **Reorganization**

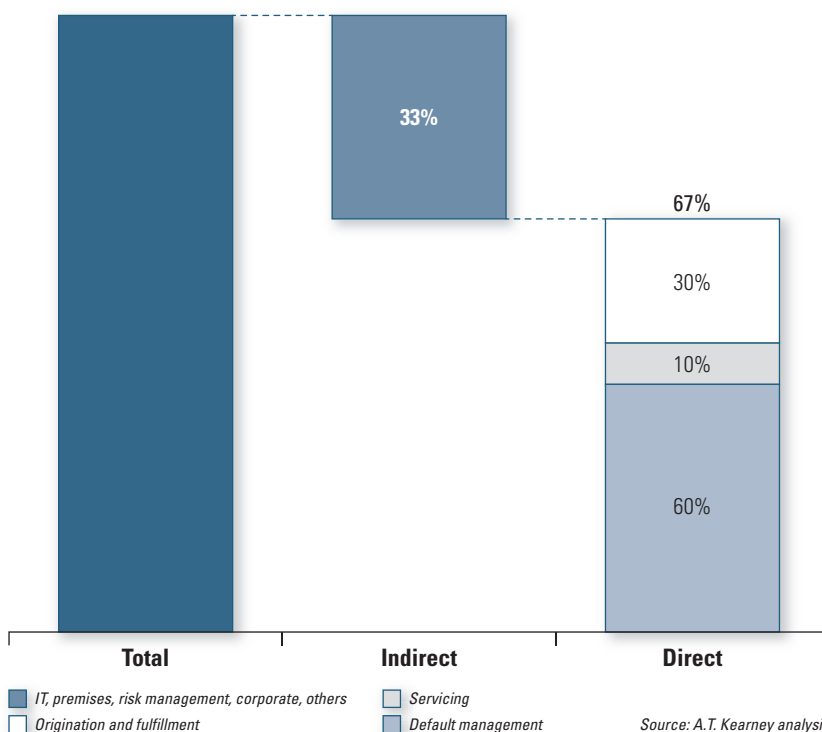
is about reorganizing people and facilities, including addressing issues of spans and layers, relocating, centralizing and consolidating locations, and establishing shared services and processing utilities. **IT enablement** is all about automating steps and improving data quality by providing tools, applying new technologies and improving information quality. **Outsourcing and offshoring** are designed to move internal work to external service providers to "variablize" cost structures; these are typically reserved for non-core activities and targeted customer segments and require the support of a strong vendor management capability to ensure optimal performance. **Sourcing** focuses on renegotiating current contracts to reduce unit prices, improve the

quality of materials and services, and competitive displacement. **Demand management** activities target reducing the underlying workload and simplifying services by eliminating low value-add activities, rationalizing service levels, and promoting self-serve options.

Companies employing these strategies have reduced costs by 10 to 20 percent.

FIGURE: Expense profile of a mortgage lender

Illustrative



Putting the Strategies to Work

In our work with U.S. mortgage operators (including leading money center banks) and mortgage players in other developed markets, we have found that all of these strategies are applicable. The following are ways our clients have applied these strategies to improve performance and optimize costs.

Sales and fulfillment. The primary objective in sales and fulfillment is to improve performance in the sales channel (branch, broker, direct or online) and in the processing factory. As we know, recent regulations—including, mandatory waiting periods, more documentation requirements, more disclosures based on change circumstances, and restricting counter-offers—have contributed to slowing cycle times and reducing the efficacy of the process.

Better screening of leads and calls can ensure that more qualified leads make their way to agents who then can be more productive in completing applications. Managing average handling time (AHT) variability of phone agents can also help improve productivity and cut costs. Providing preemptive customer alerts and self-serve tools not only lessens workload in the channel but also improves customer satisfaction. Another successful tactic is to use six sigma methods to rationalize low value-add activities across sales, processing, underwriting and closing. Finally, workflow tools, queue management and other systems will help automate the process and thus ensure end-to-end linkages, improve performance, reduce costs and lead to better capacity management.

Servicing. From a spend perspective, servicing operations is not a large category, however, this is where the customer relationship is nurtured and managed for the duration of the loan and therefore key to the success of broader cross-selling and up-selling. Migrating customers to e-payments and e-statements helps improve customer service and reduce costs and should be central to the servicing strategy. Outsourcing (at least non-core functions and offshoring as appropriate) is a robust cost-cutting strategy, even with functions such as imaging as viable outsourcing candidates. And given the role that call centers play in providing customer service, it is smart to apply traditional call center optimization techniques, including call elimination and migration to lower cost channels, optimizing facilities, back office and support activities, and outsourcing or sourcing

(renegotiating if already outsourced).

Collections and default management. The recent economic situation, high levels of unemployment and job losses, and continued depression of real estate prices have all created a perfect storm for default management executives. Given that most interactions with borrowers (particularly in the early days of the default cycle before a loan goes seriously delinquent) are via the phone, call center tactics used to optimize servicing also apply to collections. However, they need to be adjusted for the nuances of the default process. In a similar way, some of the tactics used to improve sales and fulfillment can be applied to the loss-mitigation application fulfillment process. If anything, we found default management processes are ripe for automation and process improvements, since historically, due to low volumes, the default process has not been a business focal point. Recognizing that many of these expenses will again fluctuate as volumes move around, one approach in this area is to leverage outsourcing where possible so costs can be variable, particularly in the area of foreclosure and REO—from attorney expenses to spend on title and other services.

IT and facilities management (indirect). Like most other financial services operations, IT is crucial to operations and therefore is an area typically treated cautiously. There are several opportunities to optimize IT costs without compromising service and quality. For example, to manage software costs, we often deploy tactics such as value-based pricing, change or eliminate maintenance coverage, change license type, and eliminate

unused and redundant licenses and titles, to name a few. Additionally, there are more complex approaches available, such as applying mega-supplier leverage, which in the right circumstances can lead to rich rewards, as well as competitive bidding in some situations. To reduce facilities expenses,

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there are near- and long-term strategies. For example, sub-lease, increasing density, and optimizing unused space, can all provide near-term relief, while lease expiry management can provide a longer-term impact. Facilities management is another area that is often ripe with opportunity.

The “Secret Sauce” for Success

Our clients have improved costs by 10 to 20 percent across their entire spend bases by leveraging many of the tactics and strategies discussed in this paper. In all cases, there are common characteristics of success: a full and accurate

understanding of current costs and performance drivers, the ability to generate ideas applicable to a company's unique situation and estimate the impact on performance, and a pragmatic view of what can be changed to accomplish the desired objectives.

And, as with any change program, it is essential to have an unwavering executive mandate with consistent and targeted communications. Together, these provide the "secret sauce" for returning the mortgage business to profitability.

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